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Sub-Saharan Africa

SUB-SAHARAN AFRICA

KEY FINANCIALS				VOLUME AND MARKET SHARE						
			CAG (%)		Volume (Bio)			Market Share (%)		
	LE 1993	1996	LE93-96		LE 1993	1996	CAG (%) LE93-96	LE 1993	1996	Pts. Change LE93-96
Total Market (Bio)	103.3	97.3	(2.0)	Marlboro Red	2.8	4.0	12.6	2.7	4.1	1.4
PM Unit Volume (Bio)	9.3	11.9	8.6	Marlboro Lights	0.1	0.3	+100	0.1	0.3	0.2
PM Market Share (%)	7.3	10.7	3.4 Pts	L&M	0.1	0.3	+100	0.1	0.3	0.2
IFO (\$ Mio)	32.9	52.7	17.5	Bond Street	1.0	2.1	28.1	1.0	2.1	1.1
				Congress	0.7	1.0	12.6	0.7	1.0	0.3
				Chesterfield	2.9	2.8	(1.2)	2.8	2.9	0.1

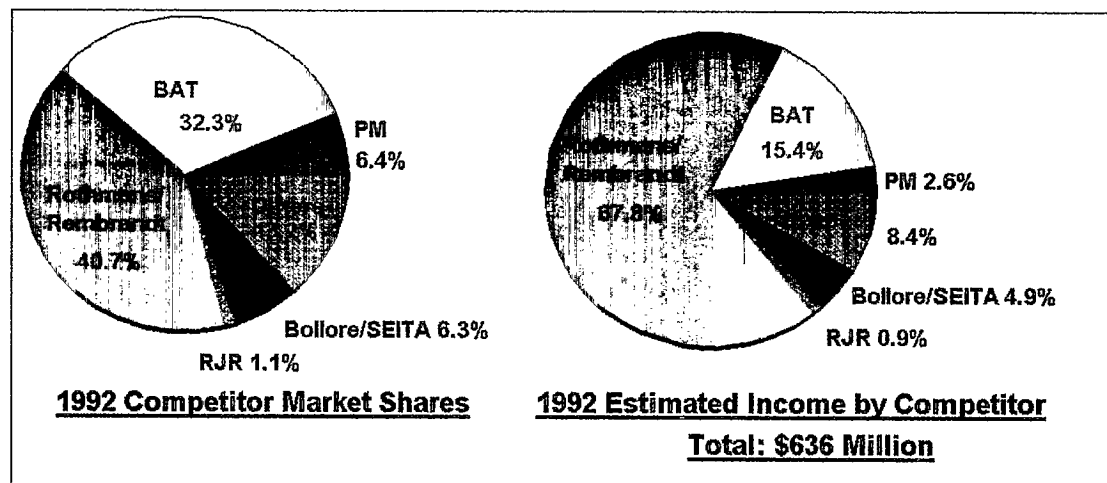
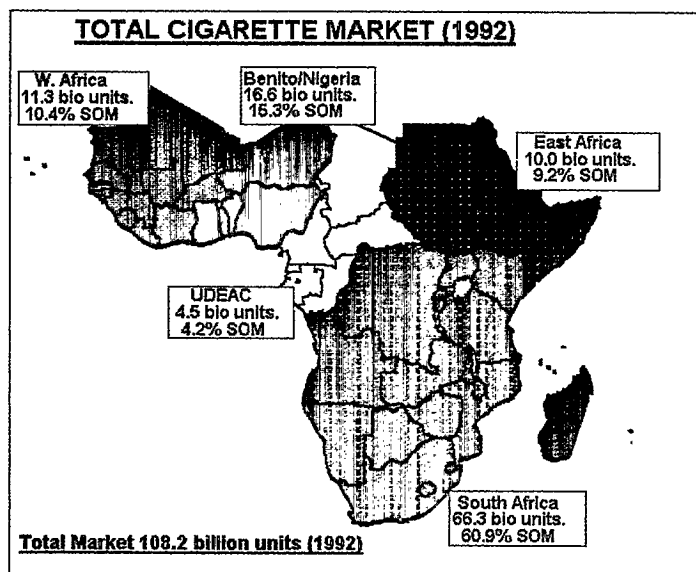
MARKET SITUATION

- Total 1993 cigarette consumption in Africa's 50 markets is estimated at 103 billion units. Sales of cigarettes are chiefly by the stick, owing to low disposable incomes. For the same reason, the premium price segment is very small.
- PM volume and income in 1993 benefited from higher export sales, despite the adverse impact of the devaluation of the French Franc, which is our billing currency in a number of markets.
- Our Plan assumes continued progress in export sales, and no change to our key license agreements with Bolloré (Ivory Coast and Senegal), Rembrandt (South Africa), and SITAR (Reunion).
- We plan to grow exports of Marlboro and low price Bond Street both in established markets and via initiatives in such new or recently opened markets as Tanzania, Malawi, Uganda, Djibouti, Sierra Leone, Kenya, Ghana, and Cameroon. This will entail developing distributors and pricing competitively. Because import duties and excise tax structures work to the advantage of already entrenched local manufacturers, we will actively lobby for reform. This will likely be most successful in markets where PM Companies is a material buyer of such African commodities as coffee, tobacco and cocoa.
- In the markets where Bolloré/Seita ("Coralma") is the sole manufacturer, we have had little success so far in achieving a co-operation agreement. Our aim in negotiations remains to secure Marlboro's leading position in the premium segment and to gain access to the below premium segments.

- In *Nigeria*, our plans include start up of local manufacture of Marlboro with cut filler early in 1994.
- In *Tanzania*, the authorities intend to privatise the monopoly, TCC. TCC is profitable and has the only factory in the 4 billion unit Tanzanian market, the only distribution system and local rights to the Sportsman and other regionally significant trademarks. We plan to appraise the value and potential of TCC and may propose to acquire it. Recognising the potential of Tanzania as a major leaf growing area, Universal Leaf are willing to approach the government jointly with PM.
- In *South Africa*, the agreements with Rembrandt and the uncertain political/economic outlook preclude initiatives for the time being.

Competition

- *Rothmans/Rembrandt* is the leading factor in Africa, owing to a dominant position in the highly profitable South Africa Customs Union markets, numerous local manufacturing bases elsewhere paired with increasing UK exports and a strategic alliance with Coralma in West and Central Africa. Important recent initiatives include purchase of an equity stake in the Coralma holding company ("Albatros Investissement") and a pending greenfield factory in Nigeria.
- *BAT* is the second competitor in Africa with dominant market positions in East Africa (except Tanzania) and good representation elsewhere except West and Central Africa. BAT's brand portfolio is ageing, however, and concentrated at the low end of the market. The company's once unassailable political strength is now eroding.
- *Coralma* (Bolloré 60%; Seita 40%) has factories in Ivory Coast, Senegal, Guinea, Burkina Faso, Madagascar, Congo, Gabon, Chad, and CAR. Coralma's monopoly of manufacture in 8 of the markets is reinforced by high tariffs which render imports uneconomic and by cost sharing in printing, filters, tobacco processing, and shipping. Coralma is highly vulnerable to the CFA/French Franc exchange rate and ownership of the partnership may be unstable, as Seita is set to be privatised, which might require restructuring of shared interests.
- *RJR's* investment in Africa is immaterial and apart from opportunistic duty free business, ongoing trade is limited to exports of Camel to South Africa, and licensed production of Winston in South Africa.
- *ATW* and *Papastratos* are also active as exporters on a small scale and *Reemtsma* is present in Cameroon, although operations are suspended due to allegations of fraud. *Japan Tobacco* are not as yet a factor in Africa.
- Estimates of competitor volume and earnings, including royalties, tobacco sales and other "off shore" income for 1992 are set out below. Figures are EEMA estimates only and are intended to suggest approximate relative performances.



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UPSIDE / DOWNSIDE

The impact of a 50% devaluation of the CFA Franc from mid-1994 would be to reduce 1994 earnings by \$5 million; 1995 earnings by \$13 million, and 1996 earnings by \$15 million.

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SUB-SAHARAN AFRICA - INCOME STATEMENT (\$ 000)

	LE 1993	OB 1994	1995	1996	CAG % LE 93-96		(\$ PER 000)				CAG % LE 93-96
	LE 1993	OB 1994	1995	1996	LE 93-96		LE 1993	OB 1994	1995	1996	LE 93-96
Cig. Volume (Millions)	9,292.4	10,390.2	11,229.5	11,946.4	8.74%						
Net Operating Revenues	106,647	120,623	140,317	154,834	13.23%		11.48	11.61	12.50	12.96	4.14%
Std Variable Cost	46,701	54,525	62,223	69,397	(14.11)%		5.03	5.25	5.54	5.81	(4.95)%
SVC Deviations	(670)	184	196	203	N.A.		(0.07)	0.02	0.02	0.02	N.A.
LIFO	1,369	1,685	1,891	2,045	(14.31)%		0.15	0.16	0.17	0.17	(5.13)%
Marginal Contribution	59,247	64,229	76,007	83,189	11.98%		6.38	6.18	6.77	6.96	2.98%
Direct Marketing	6,507	6,309	6,804	6,924	(2.09)%		0.70	0.61	0.61	0.58	6.11%
Office Expenses	9,076	7,912	8,573	9,002	0.27%		0.98	0.76	0.76	0.75	8.28%
Other Indirect Marketing	(510)	358	385	403	N.A.		(0.05)	0.03	0.03	0.03	N/A
Controllable Margin	44,174	49,650	60,245	66,860	14.82%		4.75	4.78	5.36	5.60	5.59%
Alloc. Office Expenses	-	-	-	-			-	-	-	-	
Fixed Manufacturing Exp.	11,017	11,912	12,954	13,713	(7.57)%		1.19	1.15	1.15	1.15	1.07%
General & Administrative	233	346	417	508	(29.67)%		0.03	0.03	0.04	0.04	(19.25)%
Income from Operations	32,924	37,392	46,874	52,639	16.93%		3.54	3.60	4.17	4.41	7.54%

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SUB-SAHARAN AFRICA - UNIT VOLUME AND MARKET SHARE

	VOLUME (BIO)					MARKET SHARE (%)				
	ACTUAL 1992	LE 1993	OB 1994	1995	1996	ACTUAL 1992	LE 1993	OB 1994	1995	1996
TOTAL MARKET	108.20	103.30	101.30	99.30	97.30					
Marlboro Red	2.70	2.80	3.20	3.80	4.00	2.5	2.7	3.2	3.8	4.1
Marlboro Lights	0.10	0.10	0.20	0.20	0.30	-	0.1	0.2	0.2	0.3
Marlboro Menthol	-	-	-	-	-	-	-	-	-	-
TOTAL MARLBORO	2.80	2.90	3.40	4.00	4.30	2.5	2.8	3.4	4.0	4.4
L&M	0.10	0.10	0.20	0.20	0.30	0.1	0.1	0.2	0.2	0.3
Bond Street	0.20	1.00	1.50	1.80	2.10	0.2	1.0	1.5	1.8	2.1
Congress	0.70	0.70	0.90	1.00	1.00	0.7	0.7	0.9	1.0	1.0
Chesterfield	3.20	2.90	2.80	2.80	2.80	2.9	2.8	2.7	2.8	2.9
Others	-	-	-	-	-	-	-	-	-	-
TOTAL PM	7.00	7.60	8.80	9.80	10.50	6.4	7.3	8.7	9.9	10.7

SUB-SAHARAN AFRICA - COMPETITOR MARKET SHARES (%)

	<u>1992</u>	<u>LE 1993</u>	<u>OB 1994</u>	<u>1995</u>	<u>1996</u>
Philip Morris	6.4	7.3	8.7	9.9	10.7
BAT	32.3	33.0	33.0	33.0	33.0
Rothmans	40.7	41.2	40.0	39.0	38.0
RJR	1.1	1.0	1.0	1.0	1.0
Bollere	4.2	4.0	3.7	3.3	3.0
Seita	2.1	2.0	2.1	2.2	2.3
Others	13.2	11.5	11.5	11.6	12.0
Total Market	100.0	100.0	100.0	100.0	100.0

**SUB-SAHARAN AFRICA
COMPARISON WITH LAST YEAR'S PLAN
(\$ MILLIONS)**

	1994 - 1996 PLAN			LAST YEAR'S PLAN			FAVORABLE/(UNFAVORABLE)		
	<u>LE 1993</u>	<u>OB 1994</u>	<u>1995</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
UNIT VOLUME (BIO)	9.3	10.4	11.2	9.1	9.8	10.5	0.2	0.6	0.7
OPERATING REVENUES	106.6	120.6	140.3	111.7	130.9	147.3	(5.1)	(10.3)	(7.0)
MARGINAL CONTRIBUTION	59.2	64.2	76.0	63.5	75.8	85.5	(4.3)	(11.6)	(9.5)
FME	11.0	11.9	12.9	11.6	12.6	13.5	0.6	0.7	0.6
DIRECT MARKETING	6.5	6.3	6.8	8.3	8.6	8.8	1.8	2.3	2.0
INDIRECT MARKETING	8.6	8.3	9.0	10.6	11.1	11.6	2.0	2.8	2.6
G&A	0.2	0.3	0.4	0.2	0.3	0.3	-	-	(0.1)
TOTAL EXPENSES	15.3	14.9	16.2	19.1	20.0	20.7	3.8	5.1	4.5
INCOME FROM OPERATIONS	32.9	37.4	46.9	32.8	43.2	51.3	0.1	(5.8)	(4.4)

The negative IFO variance is mainly due to a weaker French Franc in this year's Plan.

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Corporate Affairs

REGIONAL CORPORATE AFFAIRS

SUMMARY OF OBJECTIVES

The objectives of EEMA Region Corporate Affairs can be summarised as follows:

- Work to minimise absolute levels of taxation on cigarettes and keep smoking affordable.
- Work with other HQ departments (principally Planning) and the Areas to maintain or introduce excise tax and import duty structures and levels which contribute to the Region's volume and income growth objectives.
- Counter-act attempts to restrict the company's right to produce and market cigarettes.
- Stop the decline in and start re-building the social acceptability of smoking. Prevent legislation detrimental to smokers' rights in society.
- Strengthen employee morale, enhance PM's Corporate image, and create a positive business environment for management throughout the Region.
- Provide HQ project-specific support as necessary to new and developing markets.
- Recruit and train CA staff for new markets.
- Minimise costs and headcount and maximise the impact of our spending.

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The strategies to achieve these objectives are:

- Continue to develop our Government Relations capabilities in every market, including continuous CA training and the use of top level fiscal and political consultants. On key tax projects the relevant country/area manager will be an integral part of the project team.
- Seek opportunities to affect key decision makers and the media through well-trained and briefed PM or external spokespersons.
- Further develop argumentation and messages on key issues to ensure that they are factual, relevant, persuasive and interesting. Utilise PM Companies' total impact as an employer, purchaser, tax-payer, etc. to sway decision making.
- Streamline internal and external information flows; develop a joint "facts bank" with the Legal Department and make greater use of information technology in consultation with ICS.
- Ensure that all major factories have a trained Community Relations head to maximise the benefit of having PM manufacturing plants in Switzerland, Turkey and Central and Eastern Europe. This will improve the effectiveness of our pro-active Government and media relations programmes.
- Ensure better use of existing CA "tools" such as access to Corporate and branded sponsored events (also outside the Region), Corporate sponsorship of organisations such as Libertad and the AECA, and Corporate briefings to financial analysts.
- Continue to build and support industry working groups, consumers' rights and tax-payers movements groups; and establish effective PM and industry positions and solutions on issues which create conflict between smokers and non-smokers.
- Develop relevant social and cultural contribution programmes, which are carried out with sufficient frequency. Focus on encouraging local culture in the various EEMA markets.

- Continue to develop ongoing relations with affiliated PM companies in individual markets to enhance overall effectiveness of CA programmes.
- Strengthen internal communication systems to keep employees informed about Corporate news and policies.
- To continue support of the PM Brussels office in monitoring and dealing with environmental and ecological issues, including contingency planning and response training.
- Continue to improve the ability of Corporate Affairs personnel to respond effectively to all issues, by:
 - on-going and relevant training programmes;
 - strengthening of the HQ unit to provide support services particularly to "new" CA markets with an emphasis on skills in ally-building, communications, ETS and environmental issues;
 - further upgrading the daily co-operation with other EEMA departments, such as Legal, Marketing and Planning;
 - co-ordination with PMI, PMCS and other Regions and PM operating companies.

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TAXATION AND FISCAL ISSUES

The issues under this heading include tax structures, import duties and punitive taxation. We expect pressure for punitive taxation to result from increasing budget deficits and pressure from health authorities using cost-to-society claims and, increasingly, environmental claims. In the EFTA countries, the added alibi of EC tax alignment will be used to justify moves towards higher tax incidence.

Tax structure for both local and imported brands is also a key issue. Our objective is to preserve specific taxation in markets where it predominates (Sweden, Switzerland, Norway, Czech and Slovak Republics, Poland, Egypt, Denmark) and to push for a higher specific component in countries with fully or mainly ad-valorem tax (Austria, Turkey, Bulgaria, Finland, Russia, Kazakhstan, Morocco). We will also defend fiscal structures that stimulate planned local investments.

In every instance, we will work to minimise the total tax burden on cigarettes, to keep smoking affordable.

EFTA

The EFTA countries which have applied for EC membership will be influenced by EC tax harmonisation. While the ECOFIN directive will be subject to review and possible change during 1994-1995 it will be a basis from which EFTA and to a lesser extent Eastern European markets and Turkey will work.

Switzerland

Switzerland could to be a target for tax increases over the Plan period and beyond. Today's incidence of 50% of RSP contrasts with an incidence of 72% in surrounding EC countries. Switzerland's widening Federal Budget deficit will likely intensify the need for additional revenues from consumption taxes. The introduction of VAT at the rate of 6.5% in January 1995 might provoke a review of both excise tax structure and level. Excise is presently a five tier specific system.

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In October 1992 the industry submitted a detailed and comprehensive paper to the Ministry of Finance outlining the dangers of a rapid increase in the tax level and arguing strongly for a maintenance of today's predominately specific regime. In light of Switzerland adopting more and more EC legislation, a review of alternative tax structures was prepared in March 1993 for the authorities which would move them more in line with EC practice while preserving mainly specific taxation. Our relations with the authorities are good and we will continue to advise and consult with the tax authorities frequently.

Finland

After a long process of pressure from the industry led by PM, and in the face of declining state revenues, the Government finally announced a change in the tax system as of September 1992. A specific element of FIM 50 per 000 (US\$ 8.50 per 000) was introduced into the previously fully ad-valorem system. While full EC membership is not imminent, Finland almost satisfies the ECOFIN requirement on tax incidence and structure already. However our clear objective is to push for an increase in the specific to total tax ratio (currently 7%) towards the EC maximum of 55%. Importantly, we will push vigorously to retain and increase the current minimum excise tax applied to cigarettes arguing that this is allowed under EC legislation and will ensure Government revenues. We will also strive to keep cigarettes in the basket of goods used to measure consumer price inflation, as well as to decrease the tax gap between RYO and manufactured cigarettes. Our key to success will depend highly on PM's control of our licensee Amer's government relations activities.

Sweden

The emergency budget package of October 1992 included a big increase in excise tax levied on both snuff and RYO. The fiscal changes, effective December 1, 1992 which reflected intensive PM lobbying efforts, reduced the relative tax advantage of Swedish Tobacco's snuff and RYO products versus cigarettes. However, the increased total tax level has made all tobacco products less affordable.

In light of Sweden probably joining the EC by the mid-to-late 1990s and therefore realigning excise tax in line with ECOFIN, our objective is to argue for a gradual derogation towards the required excise incidence of 57% and also for the continued dominance of specific tax. This objective is reflected in the current negotiating schedule with the Swedish authorities.

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Given that Sweden will have to eliminate the weight tax classes and introduce an ad-valorem component into today's fully specific regime, there is a need for reform which we are pro-actively influencing in co-operation with STA. We will also work to reduce the rate of VAT from 25% now to 22% to reduce the overall ad-valorem component of taxation.

Norway

We will continue to work for annual rectification of the present imbalance between cigarettes and RYO taxation and strive to preserve the fully specific excise tax system for as long as it is practical. As Norway will have to accommodate ECOFIN requirements as conditions of EC membership, we will lobby and argue for a derogation in terms of the 57% excise tax requirement whilst preserving the predominance of specific taxation.

Our Norwegian CA efforts are PM specific and very sensitive due to our opposing strategic interest with the NMA member companies, particularly Tiedemanns who derive a material portion of earnings from RYO sales.

Austria

Austria is expected to join the EC by 1996. In the wake of the ECOFIN directive we have the opportunity to move today's fully ad-valorem system to one which incorporates a specific element. We have already opened a dialogue with the monopoly ATW, as a first step and plan to demonstrate in greater detail the benefits of a mixed system with a high specific component both for ATW and for the government.

Poland

On July 5th 1993, in tandem with the implementation of a VAT system (at a rate of 22%), a four-tiered specific tax structure was introduced. This is a very favourable event in light of the fully ad-valorem system formerly in place and given that the proposed tax system previously under discussion in Parliament would have included a complex mixed structure linked to usage of domestic tobacco in cigarette manufacture.

PM's objective will be to limit the overall incidence of taxation and to encourage the maintenance of a predominantly specific tax structure. While the newly adopted four-tier system is not without its problems, it does give PM a competitive advantage and we will work to reduce the gaps between the tax tiers over time. Such an approach seems to have the endorsement of the Ministry of Finance as witnessed by the recent tax change which has already narrowed the tax gaps.

In addition we are working to convince the authorities to tax tobacco rolls as cigarettes and not as RYO and to make the case against further increases in the import duty on tobacco (currently 30%).

Czech & Slovak Republics

We have so far achieved our objective in the Czech Republic of maintaining the current specific structure and to narrow the gap between the two tiers by raising the tax burden on 70mm products. However, the Slovak Republic has not narrowed the gap and now has a higher absolute level of tax than the Czech Republic. We will continue to work over the Plan period to eliminate the tax difference between 70mm and KS products in the Czech Republic and to narrow the differential in Slovakia. In addition PM will work towards securing the implementation of a minimum specific import duty to stem the flow of cheaper imports. Because recent legislation in the Czech Republic has eliminated the legal requirement to operate a primary for local cigarette manufacture, we will work to proportionately increase the import duties on cutfiller.

Our long-term strategy in the Czech Republic will be to capitalise on our positive dialogue with MoF officials and key parliamentary committees to ensure we meet these objectives. In addition to building up our contacts in Slovakia, we will work jointly with SIT/Reemtsma to introduce proposals to establish a fiscal markings system aimed at stemming the flow of contraband and independently with the Ministry of Economy to mitigate the impact of potential new customs duties between the Republics on our business in Slovakia.

Hungary

PM's objective is to preserve the current mixed excise tax system, increasing the proportion of specific tax and to ensure that any future tax increases are applied solely to the specific component at a rate which does not exceed inflation. Based on indicators from relevant decision makers, this will be achieved again this year. In addition, PM will seek reductions in

the current levels of import duties on tobacco leaf and the introduction of a significant minimum specific import duty on finished cigarette products. Finally, as in Poland, we are working to convince the Ministry of Finance to tax tobacco rolls on the same basis as cigarettes.

PM's strategy will continue to focus on mobilising support within the relevant Ministries and among tobacco growers and other grass-roots organisations as well as targeted MP's in support of its objectives. A key factor will be to cope, in Government Relations terms, with the anticipated changes in the Hungarian political scene.

Bulgaria

Our current business strategy is to concentrate on exports and strengthen our ties with the local state monopoly, Bulgartabac. We will continue to lobby for changes in the excise tax system for locally produced and international brands in order to support the economic viability of our license agreement in Bulgaria, and enhance our position for the probable break-up of Bulgartabac, already restructured into a holding company.

We have submitted a detailed proposal to the Ministry of Finance, with the support of Bulgartabac, which recommends a change from today's fully ad-valorem system to a mixed system of specific and ad-valorem excise. We have been and will continue to be active in obtaining support from politicians and members of the Budgetary and Economic Committees. In addition, we will continue our lobbying efforts to reduce the import duties on cut-filler from 40% to 10%, comparable to duty rates on BBS which have already been reduced this year in line with our proposals.

Romania

In addition to supporting our export strategy and the strengthening of ties with the Romanian Tobacco Monopoly in their move towards privatisation, we have submitted an excise tax paper to the Prime Minister and Minister of Finance in support of a mixed excise tax system to replace today's three tier ad-valorem system based on non-filter, paper filter or acetate filter cigarettes. Despite a volatile economic and political environment we are active in lobbying for the support of the Minister of Privatisation and aim to reinforce our position with relevant decision makers at the earliest opportunity.

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Croatia

Under our current plans to produce Marlboro under license as of 1994 and to potentially invest in T.D. Rovinj, we have submitted an excise tax paper to the Ministry of Finance recommending a less discriminatory excise tax system. We have been successful in reducing the ad-valorem excise tax rate from 85% to 70% of the consumer price for license/international brands, but domestic brands remain taxed at the favourable rate of 60%. We will continue to lobby for a non-discriminatory system and a lower uniform excise tax rate of 55% in order to encourage investment in the industry.

Slovenia

We are active in recommending to the Ministry of Finance a change in the current mixed excise tax system, where the ad-valorem component is dominant, to a system with an increased and single specific component. This proposed system, at the Government's request, is in line with structures prevailing in the EC and will readily accommodate VAT introduction. In December 1993, further meetings are scheduled with Government advisors.

Kazakhstan

We have already been active, post acquisition, in submitting to the Ministry of Finance an excise tax and import duty proposal which aims at encouraging the revitalisation of local manufacturing and import substitution, and the local production of higher quality brands. We are following up our initial contacts and will continue to press for the introduction of a mixed excise tax system, which includes a significant component of specific excise, and a specific import duty to protect the market from cheap imports.

Russia

Our aim in Russia is to work with the authorities for a simple, fair and enforceable tax regime which does not jeopardise our import business and which facilitates our long-term plans for local manufacture.

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The authorities have now corrected the anomaly which, previously, taxed locally made international brands at a higher rate than imports of the same brand.

Next we will work to substitute a mixed specific/ad-valorem system for the current multi-tiered wholly ad-valorem system. This is in line with our adopted proposal for Lithuania and the one put forward in Kazakhstan.

Separately, in the current political/economic context, evasion of taxes is widespread. This provides a rationale for simplification and reliance on the specific component, which precludes under invoicing, for example.

Our investment program in local manufacture gives us good standing for dialogue with the Ministry of Finance, the State Customs Committee, and the Russian State Tax Services to highlight the benefits of change.

Turkey

In December 1993 the Government made public its intention to introduce 1/1/94, subject to Parliamentary Budgetary Committee ratification, an entirely ad-valorem Special Consumer Tax which replaces all local excise taxes with the exception of the Veterans Fund (2% of retail selling price) and VAT, which effective November 1993 was increased from a 12% to a 15% rate (13.04% of the retail selling price). The Special Consumer Tax will be levied on approximately 100 products at differing rates and will be charged on cigarettes at a rate of 100% of the sum of the net ex-factory price plus Veterans Fund. Local production will, however, be afforded protection versus imports ex- EC and USA, for the Special Consumer Tax on imported finished cigarettes would be 100% of the sum of C.I.F., Tobacco Fund (\$20 / 000) and Import Duty.

In light of these developments and the subsequent increase in tax incidence for Marlboro 100 ex-Torbalı, from 64% to 68%, our strategy is to negotiate a lower rate for the Special Consumer Tax and continue dialogue with the relevant authorities to seek to include a specific element in the tax. We will therefore intensify our lobbying efforts on excise tax reform and re-submit our tax proposal, submitted in April 1993, to replace the proposed tax system with a mixed system prepared in the light of Turkey's commitment to achieve Customs Union with the EC by January 1, 1995.

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As a first step to Customs Union with the EC, Turkey introduced a two-tier import regime in January 1993, favouring cigarette imports ex-EC with a 60% customs duty, versus the common external tariff of 90%. With the proposed reduction in the cigarette duty ex-EC down to zero by 1995, we will also continue to lobby for the protection of local industry by arguing that the Tobacco Fund on imports (\$ 20 / 000) should be folded into a specific excise tax.

GCC

Our objectives and action plans remain to delay any increase in the duty level, especially in those states where duty remains at 30% (Saudi, Kuwait, UAE) and to argue for a high specific duty in all states. We will continue to lobby vigorously with the GCC Secretariat, Health, Finance and Customs officials and the USTR for a change in the duty structure while working with UAE officials to delay the duty increase, and to insist that if such an increase prevails it be accompanied by a high minimum specific duty. We have recently provided the GCC Secretariat with a rebuttal of RJR's initiative arguing for the removal of Saudi's minimum duty requirement. We believe that this event will actually strengthen our case in assuring member states that they are free to choose their own duty structure and to re-inforce our arguments in favour of specific taxation.

Egypt

We have been active both in convincing Eastern Tobacco and the Ministry of Industry of the merits of retaining today's fully specific (two-tiered) cigarette tax system. With the probable introduction of VAT in 1995 we will lobby to maintain reasonable tax levels, the continuance of a two-tier specific element and argue vigorously against any potential IMF proposals to introduce an ad-valorem system. Cigarette excise rate depends on the net ex-factory selling price. For cigarettes priced ex-factory at £E 0.65/pack and above the rate is £E 63.50/000. Below a factory price of £E 0.65/pack, the rate is £E 41.30/000. A key requirement for the success of our local brand project would be to raise the triggering factory price to £E1.00/pack. Eastern have proposed this concession already and our aim will be to ensure it is adopted. Further, we plan to maintain protective import duties on finished cigarettes and be ready to argue against increases in import duty rates on cut-filler and BBS.

Iran

Today's taxation of imported cigarettes is dominated by a specific duty of \$7.70 per thousand and a Commercial Duty of \$2.60 per thousand which together account for over 90% of the tax burden.

While the specific duty structure is favourable we have demonstrated to the Iranian monopoly that the excessively high level of duty encourages smuggling, estimated at one third of the market and that the optimum duty level is lower.

Our objective, reflected in a proposal introduced into Parliament, is to lower the specific duty from \$7.70 per thousand to \$5.10.

Africa

In Senegal, in an effort to improve access to the mid price class with imports we have submitted a proposal which recommends a reduction of the current import duty and a re-structuring of local taxation in favour of specific rather than ad-valorem tax.

In Gambia, our efforts to secure a specific import duty were partly successful when in June 1993 the authorities amended the tariff schedule for cigarettes by including a minimum specific element. This will result in a price increase for the low end of the market and improve our export possibilities.

In Cameroon, we have submitted a proposal arguing for a reduction in import duties on cigarettes in order to improve the possibility of premium priced legal imports competing with contraband.

In Mali, we have requested that imports be allowed through private importers and distributors and will also propose a revision of the taxation from today's two tier ad-valorem basis to a two tier specific system.

We are also formulating tax reform proposals in Kenya, Burkina Faso, and Mauritius.

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Lebanon

The Lebanese Finance Ministry, in an effort to boost state revenues, is currently considering the re-introduction and enforcement of an Army tax which would probably be 20% fully ad-valorem based on the wholesale price. We are documenting an alternative uniform specific tax for all imported brands which would combine today's margins generated by the Regie and provide additional revenue for the authorities without jeopardising the growth momentum of premium priced imports.

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MARKETING FREEDOMS

EEMA markets will be influenced by final action on the proposed tobacco advertising ban in the EC. Unilateral actions to ban advertising by individual nations such as France will also have an impact. Branded sponsorships as well as Cultural & Society Contributions programmes, all essential in our Government Relations work, are at risk, as is the right of third parties to purchase and use tobacco trademarks in other fields. EEMA also has the challenge of securing and maintaining relevant marketing freedoms in Switzerland, Turkey, Austria, Egypt and in the emerging markets in Central and Eastern Europe, as well as in the Baltic States. Future challenges will also include marketing opportunities in the Levant.

Action Plans

- In Switzerland, a national referendum to ban advertising was overwhelmingly rejected on 28 November 1993. The industry position was strong due to the adoption last year of a responsible voluntary industry code and was reinforced by a well articulated publicity campaign during the weeks immediately before the vote. PM led both efforts. Now anti-tobacco forces will likely attempt bans at the individual canton or municipal level and this will be the focus of on-going efforts on our part.
- In the Czech Republic, in July 1993 Parliament reversed the ad ban contained in the Consumer Protection Act. In December, in otherwise unrelated legislation ending Tabak's monopoly of manufacture, the ad ban was narrowly and unexpectedly re-instated. We will work to reverse this.
- Similarly, in the Slovak Republic, we are working with allies and the Ministry of Economy to achieve a reasonable interpretation or amendment of the CPA.
- Following an extensive and successful lobbying campaign in Poland which included mobilising a coalition of interested third parties, an advocacy advertising campaign, support from the Tobacco Growers Association and the local tobacco manufacturers, the Polish Parliament adopted the Law on Unfair Competition which excludes tobacco advertising only from TV and radio and in youth press from 1995, otherwise allowing considerable marketing freedoms. The priority now is to ensure that Parliament does not adopt any new legislation which would introduce more severe restrictions.

- In Hungary, we will seek through direct lobbying and action with third party allies to amend obsolete tobacco advertising legislation which restricts communications with consumers.
- An anti-smoking bill in Turkey which included an advertising ban and public smoking restrictions was vetoed by the late President Ozal in 1991. Virtually identical legislation was re-introduced to Parliament in 1992. Our aim is to defeat this legislation and establish a self-regulatory or, alternatively, legal code which allows reasonable advertising and marketing freedoms over the next 5 years. We have created within the association of foreign investors ("Yased"), a tobacco working group to leverage the entire business community. Furthermore, we have the support of the tobacco farmers' lobby. The PM strategy includes a plan to introduce, within a larger framework of modernised Turkish legislation, balanced cigarette marketing legislation.
- In Lithuania, a WHO-initiated draft Tobacco Law banning all tobacco advertising as well as brand diversification is circulating within the administration. Our objective is to achieve acceptable rules on tobacco advertising, either through legislation or a voluntary code.
- In Russia (and other republics), the emerging threat of anti-smoking legislation at the national and at the municipal levels will require our response. The Russian Parliament has already accepted in principle a mass media ad ban in Russia. We will work to achieve sensible implementing regulations.
- In Kazakhstan we mean to act pre-emptively to protect marketing freedoms.
- In 1994 and 1995 we expect anti-tobacco drives in Bulgaria and Romania. We will work to introduce balanced legislation in advance of the expected WHO-instigated attacks.

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PRODUCT RESTRICTIONS

From January 1994, EC legislation on labelling (HWL) and maximum constituent levels (MCL) will be applied in EEA markets (all EFTA countries except Switzerland). In Scandinavian markets and Iceland, where much stricter rules have been repeatedly proposed, we have an opportunity to liberalise MCL/HWL legislation. But in many Central and Eastern European markets there is a risk of harsher, possibly technically unfeasible strictures.

Action Plans

- We will emphasise PMI's new global labelling policy in EEMA markets when this is useful.
- In the Gulf states, where mandated tar and nicotine levels at 12 and 0.8 mg respectively are the lowest in the world, we will forestall any further reductions and will seek adoption of revised ISO sampling standards.
- In Central and Eastern Europe, imposition of T&N limits implies increased quality assurance measures in manufacturing, and potentially also puts limits on use of local tobaccos. These issues along with labelling requirements will be the subject of negotiations with regulatory authorities with the aim of securing an orderly and realistic transition for product specification changes.
- We expect intensified pressure to disclose ingredients. To counter this threat, we will work to ensure the adoption of a positive list (COE) to avoid disclosure of proprietary information on PM brands.

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THE PRIMARY ISSUE

Litigation continues in Finland and publicity regarding litigation in the US is widespread.
Our priorities are to :

- correct misinformation in the media about the outcome of litigation especially in the US;
- discourage litigation in EEMA countries;
- rebut the assertions of the anti-smoking movements and their use of the legal system, e.g. in Finland;
- correct blatantly incorrect allegations about smoking when these appear in the media.

In conjunction with our legal department we will establish monitoring and early warning systems for Central and Eastern Europe. In Third World countries, especially Africa, we will cooperate with the authorities and support efforts for the introduction of adequate and properly attributed health warning labels.

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ETS ISSUES AND SMOKER DISCRIMINATION

ETS claims are becoming the driving force behind anti-smoking activities in EEMA markets, and ETS-driven proposals for smoking bans and restrictions are no longer limited to the industrialised world. The WHO appears to be focusing its efforts on Russia, Poland, Hungary, the Czech Republic, Slovakia and Lithuania. The EPA classification of ETS as a "Class A carcinogen" in the US was widely reported and will influence the public debate on smoking issues and decision makers in the future. Our political messages and proposed solutions emphasise accommodation rather than the scientific debate. In the Nordic countries, free-standing smokers' rights groups have successfully joined the fight for reasonable smoking freedoms (e.g. by defeating a smoking ban on all European SAS flights).

Action plans

- Continue to publicise the poor science that underlies the EPA Report.
- Continue to focus on labour union channels.
- Utilise the new presentation concerning ETS solutions developed with the Science and Technology group at FTR.
- Encourage PMI to initiate and fund research into the causes and consequences of social intolerance, aiming at broadening the political debate about bans, laws, and tolerance in our societies.
- Together with PMI and PMCS, intensify the work to influence the setting of indoor air quality and ventilation standards. Parallel to this outside advisors will focus more on standards and regulations and less on scientific base work and science conferences.
- Develop allies among our supplier companies and in the HoReCa industry who have a real economic interest in the public smoking debate.

- Use PMI's ETS team to find scientific witnesses for Central and Eastern Europe, North Africa, Turkey and the Middle East, where increased ETS defence activities will be needed.
- Increase the number of legally cleared ETS spokespersons above the current total of five.

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SMOKING AND TOBACCO INDUSTRY SOCIAL ACCEPTABILITY

The vast majority of anti-smoking measures have been made possible, directly or indirectly, by the decline in the social acceptability of smoking and the tobacco industry. Marketing conduct issues, the ETS misconceptions including the adverse publicity created by the US EPA issue, misinformation about tobacco and marketing in the Third World and alleged sales to minors have been systematically used by the opponents of the industry to create suspicion about tobacco related issues.

PM, and the tobacco industry in general, must find practical, lasting solutions to relations between smokers and non-smokers. This is not unrealistic, especially in new and emerging markets where PM has made major investments.

Action plans

- Continue to set an example to the industry in supporting consumer interest groups. Through the participation of high profile delegates from labour unions, social welfare boards etc., smokers' rights groups will attract international media attention to their call for tolerance and to practical solutions for workplace smoking, restaurant smoking, transit smoking arrangements etc.
- Continue to upgrade co-operation with farmers in the third world in demanding a more realistic and fairer debate on tobacco issues.
- Continue to publicise PM's policy on youth and smoking.
- Via the media, continue to focus on the intolerance of the anti-tobacco movement in the US ("American Excess") and, increasingly, in Europe.
- Appoint community relations heads at each PM factory, train these people and integrate international and nation-wide PM programmes with local needs.

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- EEMA's Cultural and Society Contributions (CSC) programme focuses on ballet, opera and art areas where PM is experienced and which offer continuity. We will increase emphasis on such new markets as Turkey, Central and Eastern Europe and, longer-term, Africa, where meaningful contributions ideas do not demand major financial investments. The local contributions programmes will adhere to the policy of spending a minimum of 50% of the contributions funds to export indigenous arts, thus putting PM's global competence in the service of the individual markets and areas.
- Continue to identify and work with opinion leaders, as well as the International Chamber of Commerce, the International Advertising Association and their local chapters to fight legislative attempts to prevent tobacco products from being consumed by, or marketed to informed adults, and to offer viable alternatives through voluntary restraints and common courtesy.
- Work with libertarians, legislators, employers and workers' unions to prevent job discrimination against smokers and include conditions in labour contracts which allow workers to smoke in designated areas inside the workplace.

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ENVIRONMENTAL AND ECOLOGICAL ISSUES

Several European markets are introducing or discussing environmental legislation. The German legislation, demanding far-reaching recyclability of packaging and transportation material, will influence EC legislation and, in turn, EEMA countries, particularly those which aspire to EC membership.

Action plans

- In co-operation with the Legal Department, we will monitor developments relating to environmental issues , especially legislation which would affect our manufacturing facilities.
- All actions will be co-ordinated with the relevant issues head in Brussels.

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DUTY-FREE

The EC has agreed to allow intra-EC duty free to continue until 1999. Our concern is to build on the EC success in other markets, particularly ones set to affiliate with the EC. We also need to defend the DF allowances in some areas, e.g. Turkey.

Action plans

- With PMCS, re-establish the successful 1990-91 Duty Free working group in 1994-1995, and mobilise relevant Duty Free interest groups.
- In co-operation with the European duty free associations, we will use Scandinavia-Finland as an example of vendor control methods already proven effective in practice. The objective is to use this in Government Relations work to extend the duty free business.
- Through third party allies such as the leading Nordic ferry lines we will work to increase the quotas in Finland and Sweden.
- Via labour union contacts, EEC and EEMA will jointly work to defer the abolition of duty free in markets where the national income is heavily dependent on tourism, ship building, ship chandelling, etc., such as Greece, Spain, Turkey, Finland and Norway.

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HUMAN RESOURCES

The staffing strategy over the Plan period will be to maintain a core group of specialists at Lausanne HQ for communications, Government Relations and ETS related issues and project management. Simultaneously we must expand in-market resources and expertise, particularly in Central and Eastern Europe. In addition, PM Co. Corporate Affairs, PMI, as well as Covington and Burling and Burson-Marsteller London, will be needed for standardised issues and basic spokesperson training. The formation of issue-specific Corporate Affairs task forces, mainly with PMCS but also Kraft Jacobs Suchard in Zürich, will also result in greater synergy and enhance the training and motivation of our staff.

Realising the increased need for project-specific and "fire-fighting" work in new markets, the PM EEMA organisation is being changed to a more action oriented structure, run by the Director CA and the heads of the 2 professional functions, i.e. the Government & Public Affairs and the Communications units. Functions such as ETS will be incorporated under one of the main groups and each CA employee in Government & Public Affairs and Communications is also expected to be a professional, well trained project leader for a number of given markets/types of projects.

Training

The following EEMA CA training programmes have been implemented and remain available to meet ongoing needs:

- CA spokesperson's training (separate for CA and general management)
- ETS issues training
- EEMA introductory training for new CA staff
- Basic CA skills ("tools of the trade") for new CA employees
- Business spokesperson training for line management
- Crisis management training

- Strategic Planning (phase I) for CA staff

With ICS, and in co-operation with PMI and PMCS, we will develop CA data bases appropriate to CA needs.

Our most immediate training needs in 1994 and 1995 will be in the area of Community Relations.

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Operations

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REGIONAL OPERATIONS

OVERVIEW

Regional Operations will continue to contribute to the Region's volume and income objectives by ensuring the timely supply of high quality products and by utilising available manufacturing facilities and sourcing alternatives in the most cost effective and flexible way.

During the Plan period, the main challenges will be:

- The integration of new production centres, adaptation of existing factories, support of business development initiatives,
- Optimal use of people,
- Sourcing,
- Supply of leaf and NTM's, and
- Cost reductions/productivity improvements.

Discussion of related key issues and action plans is set out below.

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KEY ISSUES AND ACTION PLANS

1. Integration of new production centres

Situation

- Support requirements for acquisitions have proven larger than anticipated.
 - On-going support at Egri, Tabak, and Philsa.
 - Additional support needed at Klaipeda.
- Demand for limited human resources for new ventures is already heavy and will increase.
 - Almaty, Krasnodar, St. Petersburg, Krakow.
 - Croatia, Romania, Bulgaria, Ukraine, and Egypt.
- Communications with remote production centres is often difficult.

Strategies

- Apply lessons learned from Egri, Tabak, and Philsa start-ups.
- Flexible and innovative use of existing manpower.

Action Plans

- At *Tabak* our chief aims are:
 - To complete the new 15 billion unit primary at Kutna Hora and make limited enhancements to improve yields at the Novy Jicin and Hodonin primaries.
 - To increase secondary running speeds and efficiencies by replacing 5,000 cpm machines at Kutna Hora with 8,000 cpm machines, and at Novy Jicin by upgrading machine speeds to 5,000 cpm. Better weight controls for 70mm products at Hodonin will also be installed.
 - To reduce NTM costs, local suppliers will be identified. In particular, Westvaco at PM's invitation will likely establish local printing operations with selling prices at a significant discount to imports.
 - To get better use of Tabak's central engineering workshop, we will undertake in-house overhauls of equipment for Tabak, PM Lietuva, and others, as required.
 - Other priorities include development of people, especially local Czech managers, information systems/cost controls and quality assurance.
 - To support contract manufacture of SIT brands for the Czech republic with a reciprocal arrangement in Slovakia for Tabak brands; alternatively prepare for make/pack manufacture in Slovakia.

- At *Egri* our chief aims are:
 - To materially reduce costs and boost efficiencies in support of Egri's major planned volume increase in the low-price segment by using the newly installed production/costing control systems, by training people, by improving weight controls, and by adding statistical process controls and QA equipment.

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- To reduce leaf and NTM costs, by sourcing leaf from markets where a preferential duty applies, establishing a bonded warehouse for imported NTM's/leaf and identifying local NTM suppliers, to minimise import duties.
 - To reduce dependence on expatriates and assure the long term viability of factory operations, by continuing to train local people and identifying young Hungarians with potential for promotion.
- At *PM Lietuva* our plans are:
 - To transfer production from the current urban facility to a new site, where a 2-shift facility is expected to be operational by 1995 to support domestic and export requirements. A third shift is contemplated after 1996 when our contract manufacture agreement with the Kaunas Factory expires.
 - To re-think blends for existing brands which show promise and re-design packaging.
 - To implement cost, quality, and safety programs along with appropriate training.
- At *Krasnodar* we plan:
 - To assure safety and essential plant services as our first priorities. Training will also commence immediately.
 - To install Skoda makers and packers (now held ready at Tabak) with Tabak assistance and training.
 - Later, to construct a new primary/secondary building while upgrading existing buildings.
 - To install a new primary and better secondary equipment, bringing capacity from 6 billion at present to 12 billion units.

- At *St. Petersburg* we will:
 - Finish installation of two make pack groups - sufficient for an initial 1 billion units per year, with planned start up in the second quarter of 1994.
 - Add a third make pack group when needed.
 - Look for a suitable site for a new 10 billion unit facility and finish the related feasibility study in 1994.

- At *Samara* :
 - We plan to make use of the available 0.5 billion units of make/pack capacity for international brands.

- At *Almaty*, our plans are as follows:
 - Safety and essential services will be assured.
 - The existing primary, which cannot produce American blend cigarettes, will be modernised and output boosted to support making of 12.5 billion finished cigarettes.
 - Existing secondary equipment will be upgraded/overhauled to increase output 25% over current levels. Papirossi production equipment will be dismantled.
 - A second new primary capable of producing blended cigarettes will be operational by 1995. This new primary will be sufficient to support making of 25 billion cigarettes per year.
 - Secondary equipment will be progressively installed to support output of 25 billion units.
 - Comprehensive training programmes for management and factory workers will be undertaken.

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Universal Leaf Tobacco Company will work in parallel in Kazakhstan to develop local tobacco cultivation, including upgrading tobacco processing and storage facilities, expansion of semi-oriental output and experimental Virginia and Burley cultivation, under PM supervision.

At **Krakow**, where we plan to acquire our local licensee and its four factories in mid-1994, our plans are:

- To expand capacity for license manufacture of Marlboro and L&M to 6 billion units by spring 1994. In the event of delays in privatisation license capacity could be further expanded to a maximum of 8 billion units.
- At the time of acquisition, we will undertake the following program:
 - Buildings and plant services will be improved where this ensures safety and continuance of output. A central QA lab for the factories will be established.
 - Upgrades for the threshing and redrying installations and reconstituted tobacco lines will be evaluated.
 - The machine shop will be adapted to serve as an overhaul and rebuild centre.
 - A local training centre will be established.
 - An operations team including expatriates will be identified.
 - Young managers with potential will be selected and trained in Western management skills.

2. Adaptation of existing production centres

FTR: Situation

- FTR is a highly flexible facility and serves as a centre for development of "best practices" in manufacturing.
- However, the domestic Swiss market is stagnant and FTR's long term export potential is limited by Switzerland's decision not to affiliate with the EC, and by PM's acquisition and factory projects elsewhere.
- Our target is to maximise production at about 17 billion cigarettes, by switching Scandinavia export to EEC.

Action Plans

- To improve FTR's cost position, we will use TQM to adapt processes, shift manning, and identify viable cost reduction projects. A key project will be evaluation of creation of a new primary in phases or, alternatively, selective replacement of aged components of the existing primary.
- To improve flexibility and assure succession, cross-training will be implemented to the maximum possible extent.
- To assure business continuity, in the context of pending contract negotiations, all personnel will be fully briefed on cost reduction strategies. Productivity gains will be identified to maintain current benefit levels.
- To leverage FTR's superior know-how, FTR will serve as a "sister factory" to Krasnodar to aid in training.

Philsa: Situation

By shifting to local manufacture of our brands, we gain control of pricing and other key aspects of our business, as set out in the PM EEMA Board proposal of September 1993.

Action Plans

To eliminate the need for imports, we will add make pack equipment in line with market demand to an eventual 21 billion units capacity, roughly equal to the 3-shift output maximum of the primary. Three shift capacity for the plan period is set out below.

(Units, Bio)	<u>1993 LE</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
Primary	15.0	22.1	21.9	22.3
Secondary	4.7	12.5	16.0	18.1

The effect of the machinery installations will be to eliminate the need for imports of established brands during 1994 and give us needed flexibility to launch competitive new products.

- To achieve a superior cost position, we will:
 - Train and cross-train 150 recently hired operators, fixers, and supervisors in 1994.
 - Improve safety.

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- Further enhance quality and cost control systems.
- Identify local NTM suppliers, notably in printing where international printers LMG have committed to local operations in part at our prompting.
- Increase bonded storage, minimising funds needed for working capital.
- Determine the level of inclusion for local tobaccos, which do not attract import duties, including locally grown flue-cured and burley leaf generated by our own local agronomy program.

3. Support of business development initiatives

Situation: Central Europe South

Sanctions on Serbia preclude any PM access to Serbia's 27 billion unit potential market. At the same time, due to civil war in the formerly 8 billion unit Bosnia-Herzegovina market, our former licensee Fabrika Duvana Sarajevo (FDS) has ceased operations. Separately, our license agreement with FDS expired April 1993. Our aim during the Plan period is to establish local manufacture in Croatia and evaluate other possibilities in the former Yugoslav markets.

Action Plans

- We are negotiating with the Tvornica Duhana Rovinj (TDR) factory in Croatia for license production of Marlboro (1994) and L&M (1995) using cutfiller. This would entail selective adaption of equipment and ongoing technical support.

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Situation: Romania

While we will not press for privatisation of the six factories of the Romanian Tobacco Monopoly (RTM) during the Plan period, we will work to assure good relations with the authorities by providing assistance to RTM, and position ourselves to acquire RTM's best factory at Timisoara.

Action Plans

- We will assist in developing blends for a low priced joint brand.
- We will loan rebuilt make/pack equipment to RTM to manufacture one billion units annually.
- PM will train RTM's people, as the skills base is poor.

Situation: Bulgaria

Bulgartabak may begin to restructure its operation, possibly resulting in competitive bidding for the factories. Our aim is to establish PM's presence in BT's best available facility at Sofia, by means of a license agreement for Marlboro and a low cost brand.

Situation: Ukraine

Our plan is to acquire the Kharkov factory as of mid 1995, local economic and political uncertainties permitting. Modernisation and the addition of new equipment would boost capacity from 5 billion now to 9 billion.

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Action Plans

- Prior to acquisition, technical and other assistance may be required to sustain operations.
- In the event of acquisition safety and essential services must be assured.
- Spare parts would be provided to renovate currently disabled machines. The primary would also be modernised.
- Following these corrective actions, new secondary equipment would be introduced and a wholly new primary built.

Situation: Egypt

Eastern, the Egyptian monopoly, contract manufactures PM brands at a dedicated "factory within the factory" at its Talbia (Cairo) facility, under close PM technical supervision. We will propose to Eastern to develop a joint brand, preferably a PM trademark to gain access to the domestic segment which comprises over 90% of the market. We would need access to Eastern's Alexandria factory for this project, as it has a newly installed and under-utilised primary. We would also require additional make pack equipment at Talbia. Depending on market performance of the joint brand, we would consider consolidating all PM operations at a greenfield site, including the Marlboro and L&M production now done at Talbia in Cairo.

Action Plans

- Expansion of existing license sales of Marlboro, Merit, and L&M will require additional cigarette making and printing equipment, continuous supervision/training of Eastern's low-skilled staff.
- To support a joint brand, yet more equipment would be needed.
- A suitable area for make/pack equipment, ancillary equipment and QC lab, would have to be identified.

- The Alexandria primary would be adapted to PM technical standards.
- A primary supervisor for Alexandria would be hired and trained in order to ensure permanent supervision of primary operations as soon as we start using BBS.

Situation: Iran

Our new protocol with the Iranian Tobacco Company (ITC) provides a potential new basis for our growing business in Iran. To ensure success:

Action Plans

- We will provide needed contract manufacture volumes of the new Bahman and Tir blends at competitive prices to ITC.
- We will provide agronomy assistance, technical assistance, and training to ITC's personnel. Universal Leaf will be enlisted to aid in development of agronomy.
- We will provide all necessary technical support to evaluate the feasibility of a joint venture and possible joint brands.

Situation: Syria

Local manufacture/license operations are now possibilities in this long-closed market should this become desirable. We will evaluate technical requirements for manufacture and the need for training. We would likely enlist the help not only of FTR but of equipment vendors.

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Situation: North Africa Excluding Egypt

In Morocco the monopoly will soon complete a major new factory in Casablanca and will likely mandate license manufacture of our brands locally. This will require an evaluation of their capabilities and possible technical assistance to meet our manufacturing requirements.

In Algeria, we will be ready to aid in restarting license operations, should this become desirable.

In Tunisia, to maintain good relations with the monopoly RNTA, we will continue to provide technical assistance on a small scale to demonstrate our reliability. Separately we will work to develop an appropriate product should the below-premium price segment open to us.

Situation: West Africa

We will continue to provide support for our Bolloré licensees in Ivory Coast and Senegal with emphasis on training, as FTR resources are becoming strained.

Action Plans

- In the event of a CFA devaluation, which would increase demand for locally made PM products, we will be ready to boost production in line with demand.
- We will switch blends from 87% BBS/13% ET to 83% BBS, 13% ET and 4% IS to achieve better filling power at better cost.
- We will look to source ML blanks from Senegal to reduce import duties.

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Situation: Nigeria

We plan to start production of ML KS Box with cutfiller ex USA and Bond Street with cutfiller ex FTR. This will entail upgrade of the factory, implementation of quality and infestation controls, and installation of make pack equipment. To keep our local brands affordable we will reduce plug lengths to reduce imported filter tow.

Situation: Tanzania

We will aid in evaluating the capabilities and potential usefulness of the Tanzania factory, as required, to facilitate a potential bid. Universal Leaf are willing to work on development of local leaf production.

4. Human Resources

Situation

- Availability of staff for new ventures is limited mandating innovative use of people.
- On-the-job and external training needs will increase materially and require substantial up-front investments which will not immediately improve the bottom line.

Action Plans

- Operations Support Concept (OSC).
 - Each new affiliate to have a parent factory providing functional expertise.

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- Support co-ordinated by designated project sponsor from parent factory.
 - At the newly acquired factory:
 - Two permanent expatriates (for Operations).
 - Rotating support teams with functional experts.
 - First test: FTR/Krasnodar.
-
- Recruitment: We will ensure we recruit only high quality, properly skilled people with the ability to develop and adapt to new technologies and other business requirements.
 - At acquired factories: We will establish proper job descriptions to allow evaluation and sensible rewards systems.
 - Training programs will centre on key competencies and key jobs necessary to business success.
 - Training will also aim at achieving independent functioning of each factory, by establishing on-going local programs (on the job training; cross training).
 - Standardisation of programs will be pursued for the maximum extent possible, allowing for varying technologies. Training programs will anticipate technology changes.
 - Management training of high potential personnel will enable local managers to achieve their tasks most efficiently, depending on functions.

5. Sourcing

- Total production requirements will double to 228 billion in 1996, with over 80% of the volume increment to be sourced from newly built or newly acquired factories, including the four factories of ZPT Krakow in Poland, assumed acquired in mid-1994.
- PM Brazil will continue to increase importance as a highly flexible source of low cost products, primarily for Eastern Europe and the Levant. To ensure flexibility and allow for surges in demand, we may want to source some low cost products from Tabak as well.
- In many markets, "made in USA" remains an essential feature and we expect PM USA volume will remain stable. PM USA's share of total EEMA sourcing will diminish, however, from 37% in 1993 to 17% in 1996.
- Volume from licenses will increase in absolute terms but decline as a portion of the total Regional mix.
- While the plan forecasts increased production from FTR, exports to the EFTA markets will likely be resourced to EEC, assuming Sweden and Norway join the Community. Our target is to maintain FTR production at 17 billion. FTR will increase importance as a training site and continue to develop "best practices" for other factories.
- A key ambiguity in our sourcing plan is recent US local content legislation, which could necessitate partial/gradual resourcing of volumes from US factories to Europe.

EEMA UNIT VOLUME BY SOURCE

	<u>LE 1993</u>	<u>OB 1994</u>	<u>1995</u>	<u>1996</u>	<u>Increase/(Decrease)</u> <u>1996 vs. LE93</u>
US Exports	42.2	36.6	36.3	39.2	(3.0)
Brazil	9.5	20.4	22.9	26.4	16.9
EEC	2.5	1.8	1.9	2.1	(0.4)
Licenses	12.4	13.8	15.3	16.6	4.2
Contract Manufacturing	-	0.1	0.4	0.5	0.5
FTR	15.9	17.0	17.8	18.9	3.0
Egri	4.3	6.8	7.6	9.3	5.0
Tabak	17.6	18.5	18.8	19.0	1.4
Krakow	3.8	22.6	39.8	40.0	36.2
Lithuania	2.2	5.6	5.9	6.0	3.8
Samara	0.2	0.3	0.5	0.5	0.3
St. Petersburg	-	0.5	1.3	2.0	2.0
Krasnodar	-	5.5	7.5	8.5	8.5
Almaty	-	8.2	13.3	16.2	16.2
Kharkov	-	-	2.5	6.0	6.0
Philsa	4.1	11.6	14.8	16.8	12.7
TOTAL	114.7	169.3	206.6	228.0	113.3

Sourcing as per financials,

Operations objective is to maintain FTR production at 17 billion by switching Scandinavia volume to EEC in 1996 and to reduce Brazil production by switching some exports for Russia to Tabak.

*(Billions of Cigarettes)

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6. Supply of leaf and NTM's

Situation:

- Attractively priced additional purchases of leaf are possible due to market prices, but leaf cash management is an issue.
- Non-tobacco materials offer immediate possibilities for cost reduction.

Action Plans: Leaf

- The development of innovative products and the re-engineering of existing brands are continuous challenges in order to penetrate existing as well as new markets, develop new segments, counter competitive moves and comply with changing product legislation.
- Key parameters for leaf operations are:
 - Achieving lower costs for superior quality tobaccos and proper consistencies.
 - Optimising cashflow.
 - Aligning products with consumer trends on deliveries.
 - Improving sourcing flexibility.
- In developing new products or "fast-adapting" newly acquired local brands, we must adhere to cost, taste, delivery, size, and timing requirements while creating cigarettes which consumers markedly prefer to competitor offerings.

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- The products will be designed in order to use as much as possible standard cigarette specifications and materials for the full flavour segment (tar mg/cig 12-16), and the light and ultra light segments (tar mg/cig 1-12).
- Due to filling-power improvements, average unit leaf usage will decline.
- During the Plan period the Leaf Purchasing Plan will be modified according to cigarette sales, new factories and the domestic crops, blend modifications, and changes in tobacco duties.
- Flexibility will be maintained to buy tobacco whose type, quality, and price are attractive for strategic reasons, even if not specified in the Leaf Purchasing Plan. The transfer of tobacco stocks to different destinations will be considered, if appropriate. Reconstituted tobaccos will be evaluated.

Action Plans: NTM's

- Push for strategic alliances with a reduced number of suppliers .
- Change paper/board type and weight when technically and economically sensible.
- Encourage local supply sources.
- Investigate offset/flexo printing possibilities for local brands.

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7. Productivity improvements

At all our manufacturing facilities, we will continuously look for ways to cut running costs, eliminate waste, improve leaf usage and minimise manning levels. Our established factories already have good programmes in place and we mean to improve them. At greenfield sites we will adopt superior and cost effective technologies with the aim of achieving the lowest possible cost position. At acquired facilities, our initial focus will necessarily be remedial actions: fixing safety and security problems, repairing key machines and support systems to keep our factories running, debottle-necking process flows, eliminating waste, especially of tobacco, and training people in PM quality assurance and maintenance methods. Concurrently we will dispatch industrial engineers to identify and prioritise projects which yield the best returns. Regarding manning levels, we will consider voluntary redundancy programs or rationalisation where this is sensible and has a positive payback while taking account of relevant employment guarantees and the planned expansion of our business. We have a major opportunity to cut the cost of NTM's by working with key suppliers and by qualifying local suppliers, thus avoiding duty on imported packaging and other materials.

Business process improvements (TQM)

- Establish a "unique" set of forecasts as a base for all planning.
- Improve initial definition of new projects to pre-empt unnecessary development costs.
- Enhance information flow within EEMA HQ and between EEMA HQ and affiliates.
- Review reporting practices, encourage exception reporting.
- Standardise products and materials.

Cost and productivity improvements

- Establish FME and product cost targets prior to sourcing decisions and launches.
- Streamline supplier qualification procedures to save time and money.
- Maximise asset utilisation by evaluating 3-shift/7 day work weeks on stable volumes.
- Evaluate leasing equipment to reduce capital expenditure costs.
- Use staff cross-functionally at production centres.

8. Research & Development

The aim of R&D is to provide workable technical solutions in support of Plan objectives in the areas of quality, cost, productivity, and capacity.

- We will work to fulfil consumer expectation of quality, notably the visual impact of the cigarette.
- To realise the full potential of new generation make pack machinery and other technological improvements we will ensure that tobacco, NTM's and other source materials meet machine requirements. This will entail sophisticated sampling techniques, process control, and working with suppliers to ensure "zero defect" inputs. The cost of non-quality will also be demonstrated.
- We will assist affiliates in optimising yields, productivity, and product quality as required.
- We will work to further improve existing products and develop appropriate new ones in support of EEMA's expansion plans.

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- We will constantly monitor new technological developments in search of useful new products and processes with the aims of innovating when necessary and responding rapidly to competitors.
- We will also asses direct and indirect competitor initiatives.
- We will continue to asses the impact of ETS on air quality in concert with Science and Technology and Corporate Affairs.
- We will evaluate compliance with product and manufacturing regulations, including environmental issues.

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REGIONAL INFORMATION SYSTEMS

Situation

Over the Plan period, we expect:

- Continued rapid expansion of business and, consequently, volume of information transactions.
- Increased complexity of functions and inter-relations.
- Decentralisation over an enormous geographic area.

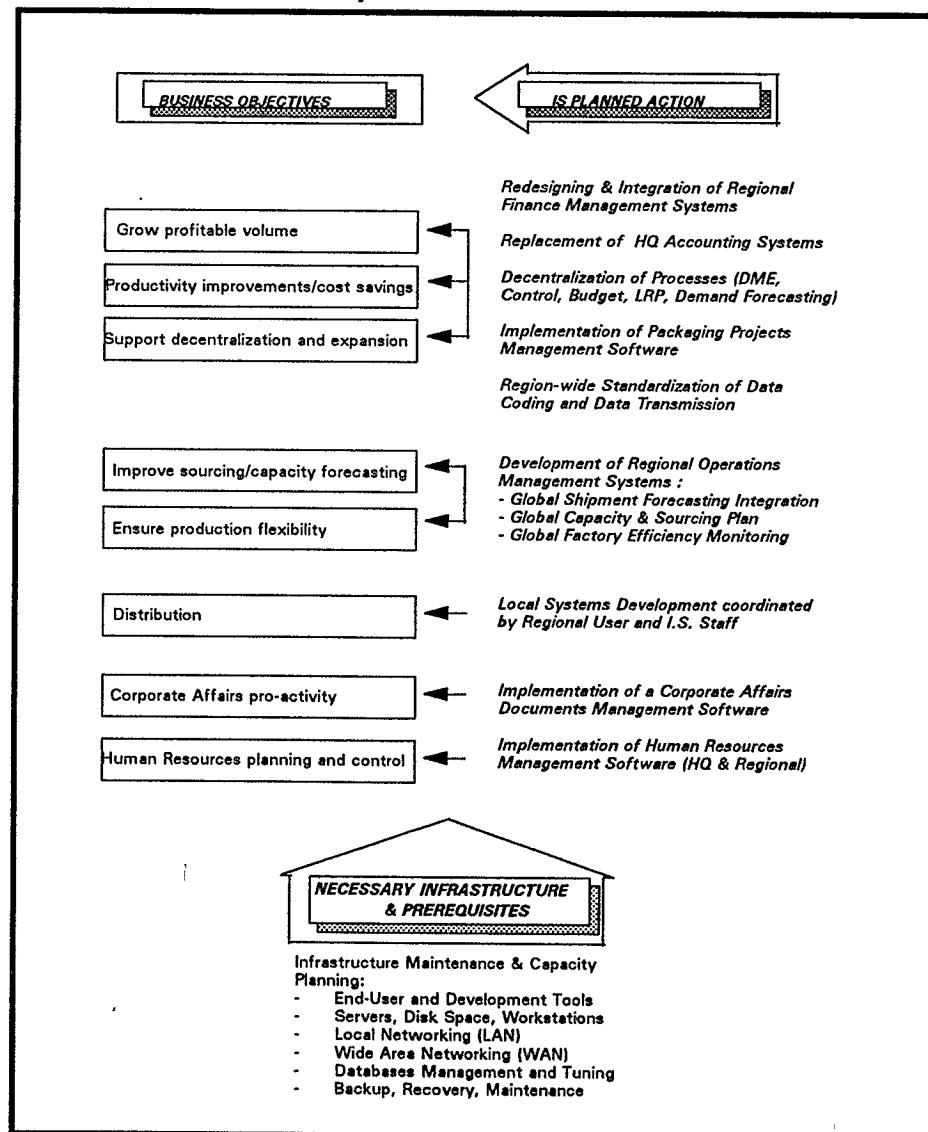
Strategies

The I.S. mission is to understand business/user requirements and provide cost effective solutions.

To this end, our strategies are:

- To automate, streamline, and enhance business processes by reducing manual processes to minimise headcount.
- To provide cost-effective software, equipment and services, to service the end-user community.
- To improve I.S. productivity by reducing unnecessary tasks and maintenance , by using technology, by adapting existing solutions, by challenging cash outlays, by improving quality of deliverables.
- Outsourcing, when appropriate.
- Training and development of local I.S. personnel in new acquisitions.

Key Planned Actions Are:



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Finance Department

Planned Actions

For Budgeting

- Improve automation of Regional Management reporting.
- Adapt the Area Budget Preparation module for use in remote locations.
- Adapt the Area Budget Preparation module for use in long range planning.
- Automate manufacturing centre/HQ budgeting interface.

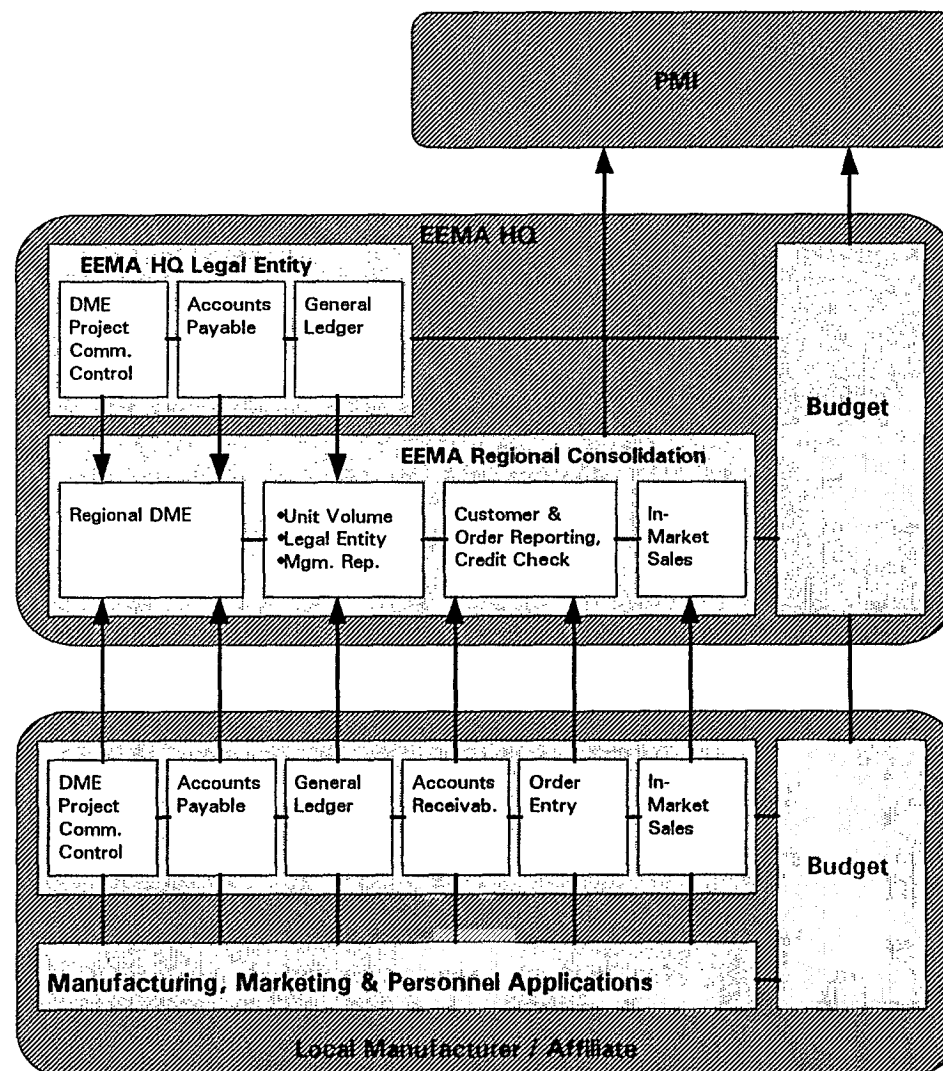
For Customer Service

- Improve Antwerp stock management.
- Store/retrieve actual and budgeted net FAS prices.
- Automate/integrate replacing of PMH and PMG export orders with EEMA HQ systems.
- Unify order entry system, regardless of sourcing decisions.

For Treasury

- Provide capital expenditures project tracking/consolidation/reporting.
- Provide a connection to the International Treasury Applications to aid in cash/FOREX management world-wide.

Finance Systems Overview

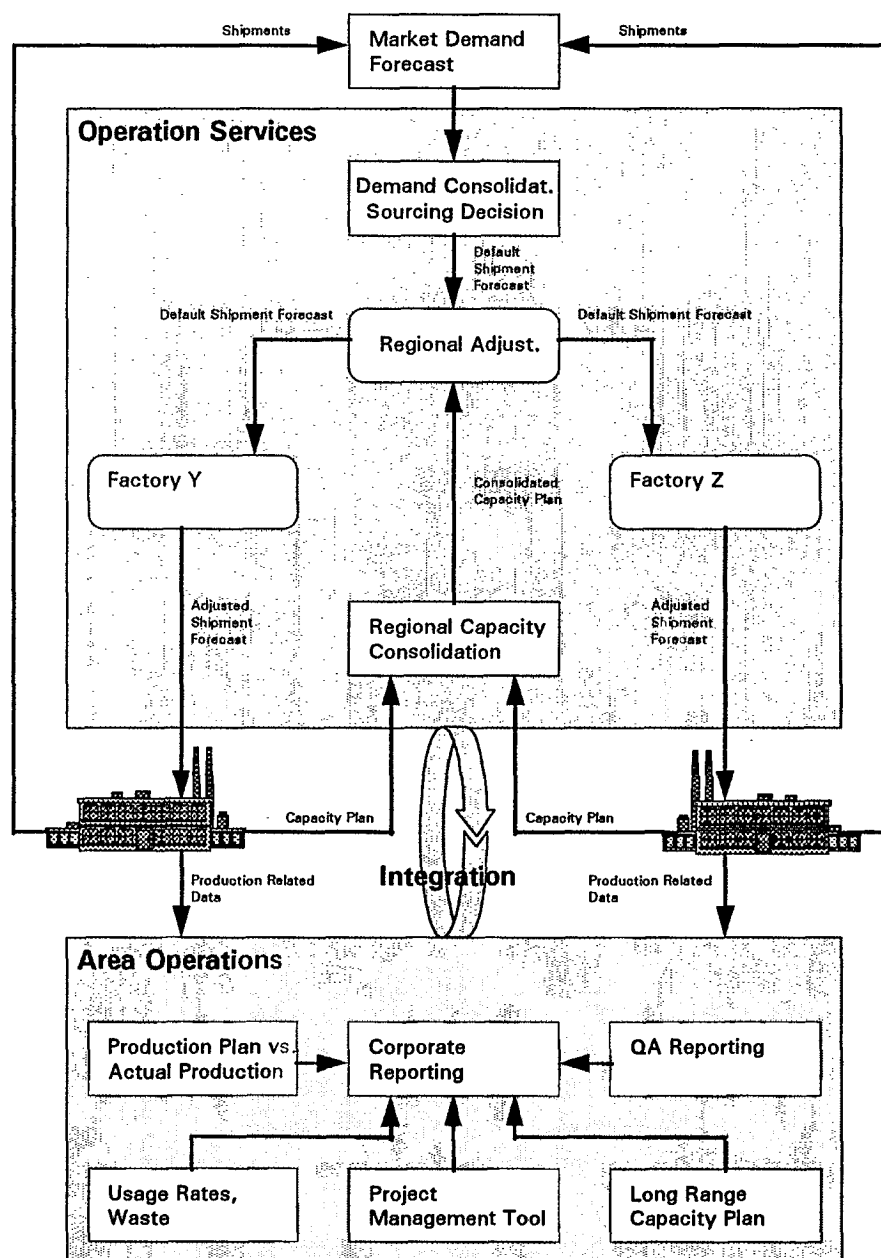


Operations

Planned Actions

- For packaging development projects, provide automated recording/tracking of items, scheduling and costs.
- Provide demand based forecast for manufacturing centres. Related to this: integrate market demand forecasts with the PMI system.
- Provide a Regional capacity plan consolidation.
- Implement standard software packages locally for production/efficiency. Longer term, potentially give region-wide production monitoring.

Operations Services and Area Operations Applications Overview

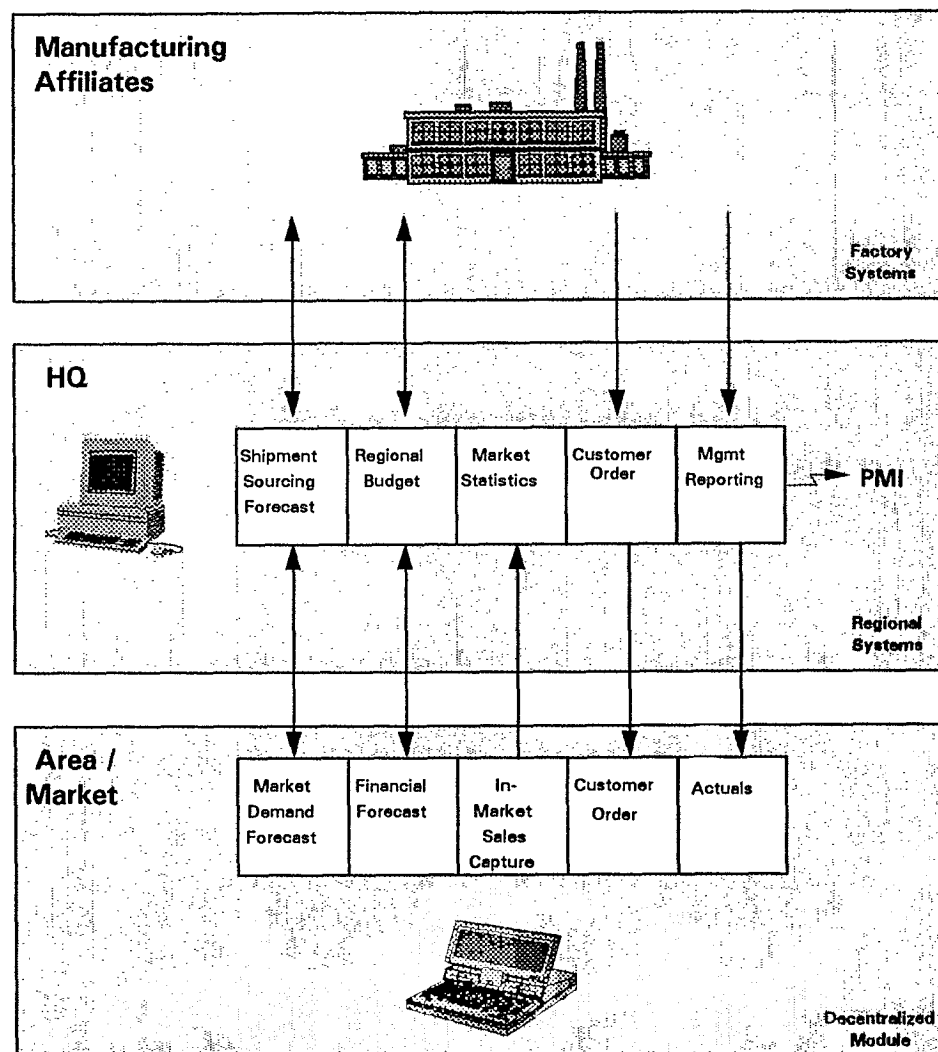


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Areas

Planned Actions

- Decentralise budget preparation, DME/commitment controls, in-market sales data and other functions.
- Assure automated communication among HQ, Areas, manufacturing centres (see diagram).
- Speed up reporting, eliminate paper by enabling electronic transfer of standard reports.
- Establish PROFS comprehensively throughout the region.



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Marketing Department

Planned Actions

- Enable colour image transfer among HQ, Leo Burnett-Frankfurt, Leo Burnett-Dubai, assuming cost effectiveness can be achieved.
- In support of sales and distribution initiatives, establish systems for direct delivery, sales force management, key account management.
- Improve the HQ POSM purchasing system.

Corporate Affairs Department

Planned Actions

- Achieve storage/sharer exchange of documents, utilising LAN's. Investigate advanced technologies for videos, etc.
- Achieve access to other CA databases where available. Establish access to useful external databases as well.
- Evaluate desktop publishing to support CA presentation needs.

Planning Department

Planned Actions

- Establish direct inquiry capabilities with relevant regional information systems.
- Work to integrate production, budget, actual, and in-market sales databases.

- Provide access to external databases in support of such areas as excise tax, import duty, economics, and demographic data.
- Evaluate desktop publishing to support presentation requirements.
- Establish a standard financial model for acquisitions and other special projects.

Personnel Department

Planned Actions

- Further enhance the capabilities of the existing HR system.
- Ensure proper, standardised implementation of HR systems at new affiliates.

Legal Department

Planned Actions

- Provide access/sharing of stored electronic documents among EEMA/EEC and PMI and PME via existing LAN sources and LAN to LAN communications.

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